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TRENDMACRO LIVE!

On the March FOMC

Wednesday, March 20, 2024
Donald Luskin

It's official: the neutral rate is higher now. And the end of QT comes "fairly soon."

Update to strategic view

FEDERAL RESERVE, US MACRO: Very much as we expected, the FOMC…

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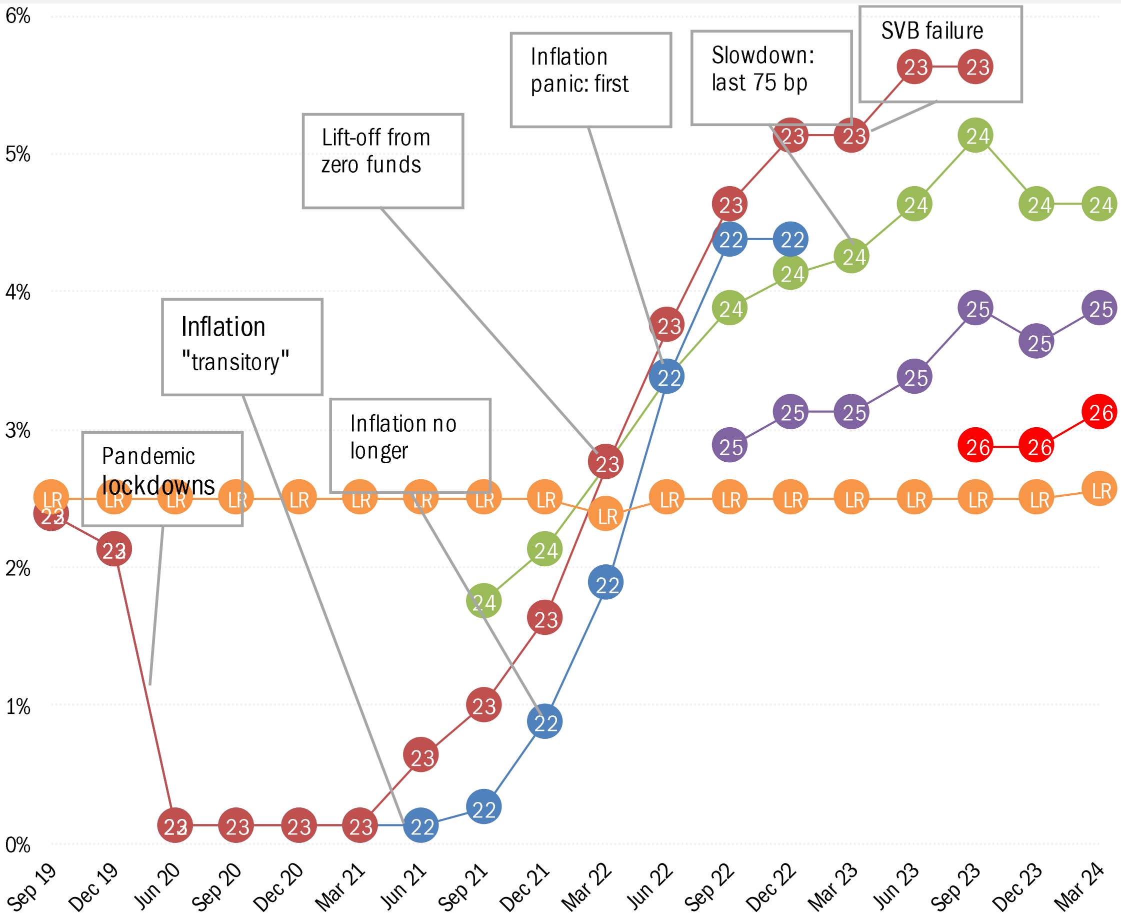
Exactly as we predicted yesterday (see "FOMC Preview: Paradoxes Mean Probable Policy Paralysis" March 19, 2024).

- No rate change, of course.
- Only six words were changed in the FOMC statement: "Job gains have ~~moderated since early last year but remain~~ remained strong…"(see "Data Insights: FOMC" March 20, 2024).

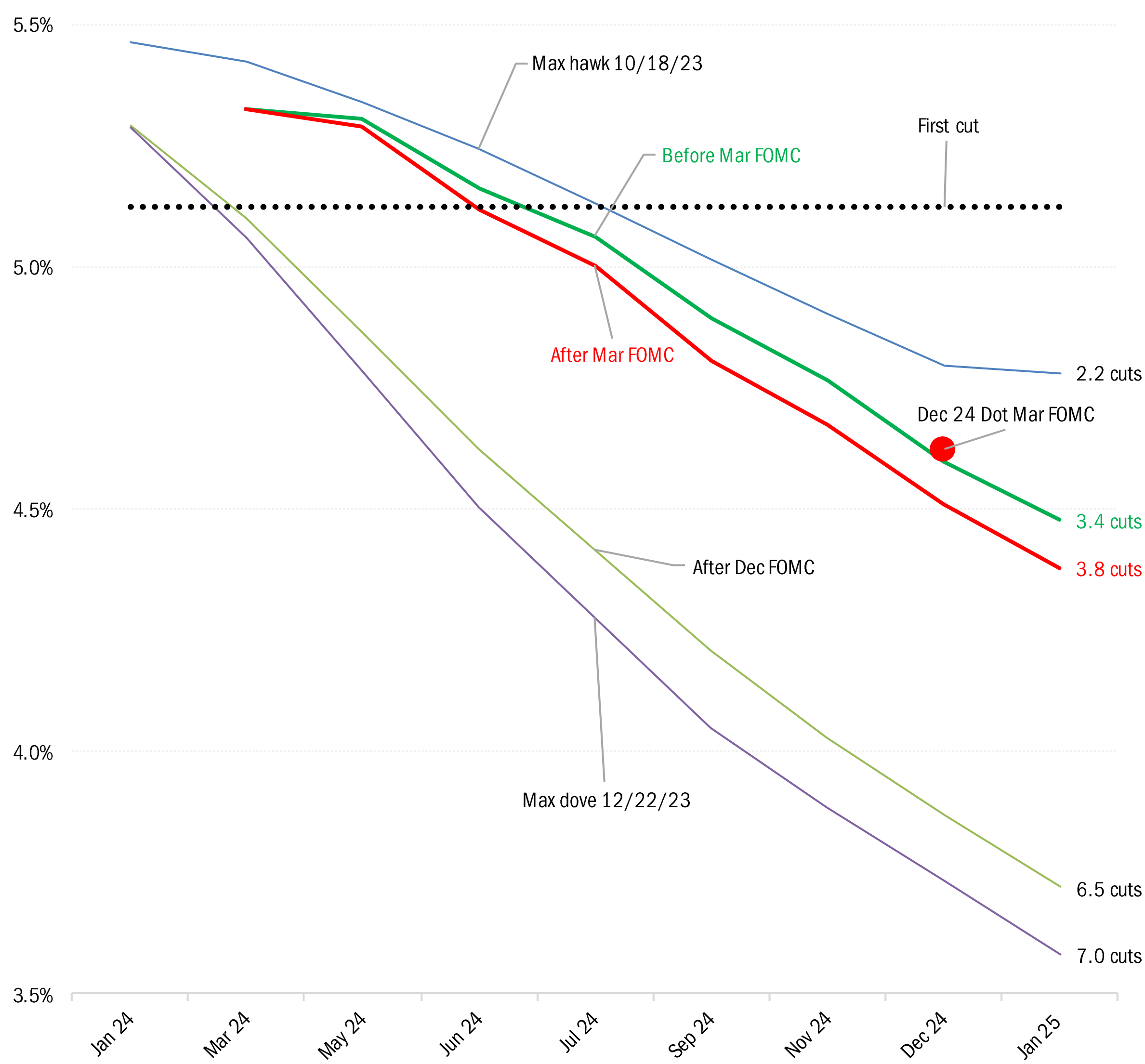
"Dot plots" from Summary of Economic Projections, "appropriate" policy rate at year end, by FOMC meeting



Source: Bloomberg, TrendMacro calculations

- No change to the "dot plot" for the funds rate at the end of this year – still 4-5/8%, implying three rate cuts (please see the chart on the previous page). And no change to the 2024 inflation estimate in the Summary of Economic Projections – still at 2.4% for PCE. In the post-meeting presser, Chair Jerome Powell wrote off hotter-than-expected January and February inflation readings as anomalies, saying "there's reason to think that there could be seasonal affects [sic] there," much as we have argued (see "Today's CPI Miss" February 13, 2024).
- *But at the same time, the SEP upgrades its estimate for 2024 real GDP growth to 2.1% from 1.4% – an amazingly large revision – and the unemployment rate from 4.1% to 4.0%.*
- That's been enough of a dovish matter to drive something of a risk-on reaction in markets, as of this writing, and change futures-

Futures-implied funds rate, by FOMC meeting, before and after today's FOMC meeting



Source: Bloomberg, TrendMacro calculations implied expectations from 3.4 rate cuts by next January, prior to today's meeting, to 3.8 after (please see the chart below).

- _The combination of higher expected growth, but no higher expected headline inflation, means the FOMC has upgraded its estimate of the neutral interest rate. Indeed, as we predicted, the "longer-run" dot was upgraded from 2.5% to 2.56%, a small increment to be sure, but the first move above 2.5% in more than five years_ (again, please see the chart on the previous page).
- _In harmony with this, the FOMC also raised its dot for year-ends 2025 and 2026_ (again, please see the chart on the previous page).
- Asked specifically about the upgrade to the neutral rate implied in the "longer-run" dot.

  Question: "Can you speak about what might be behind that? Is there a real sense here that the economy has perhaps changed in some way that higher rates will be needed in the future?"

  Powell: "So you're right. They're pretty modest changes, but you're right, there was an uptick in the longer run rate and also there's a 25 basis point increase in '25 and '26 in terms of are rates going to be higher in the in the longer run…

  "… we think that rates were generally low during the pre-pandemic, post-Global Financial Crisis era, for reasons that are mostly important, slow moving large things like demographics and productivity and that sort of thing. …my instinct would be that rates will not go back down to the very low levels that we saw, where all around the world there were long run rates that were at or below zero, in some cases. I don't see rates going back down to that level…"

- If all that sounds familiar, it's because it's exactly what we've been saying since the pandemic. The war against the virus was a countershock that re-set the global economy, lifting it out of the post-GFC era of "secular stagnation."
- Also as we predicted, in the post-meeting presser, Powell said that the committee had begun discussion of ending the run-off of the Fed's securities portfolio – so-called "quantitative tightening." – indeed saying that the pace of run-off would slow "fairly soon."

  "At this meeting, we discussed issues related to slowing the pace of decline in our securities holdings. While we did not make any decisions today on this, the general sense of the Committee is that it will be appropriate to slow the pace of runoff fairly soon, consistent with the plans we previously issued. The decision to slow the pace of runoff does not mean that our balance sheet will ultimately shrink by less than it would otherwise, but rather allows us to approach that ultimate level more gradually. In particular, slowing the pace of runoff will help ensure a smooth transition, reducing the possibility that money markets experience stress and thereby facilitating the ongoing decline in our securities

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…stood pat with almost no changes to the meeting statement, and no change to the 2024 dot – still at 4-5/8%, implying three rate cuts. Also as we expected the Fed has upgraded its conception of the neutral rate. We see this in the fact that while there are upgraded forecasts for growth and unemployment this year, there is no change to the inflation estimate. Powell wrote of hot January and February readings as driven by seasonal factors, much as we have argued. The "longer-run" dot was raised slightly, the first time above 2-1/2% in over five years. Powell acknowledged this was because of a version of our view that the post-GFC era of "secular stagnation" is over. Powell announced that slowing the pace of securities run-off with come "fairly soon," and subject to further discussion. It will be a gradual process, to minimize market disruption. We don't see this as significant, because we see "quantitative tightening" as something of a myth.

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holdings consistent with reaching the appropriate level of ample reserves."

- In response to questions, he would not amplify as to what "fairly soon" means, except to say it will require further discussion. He was clear that whenever it starts, the Fed's strategy is to taper securities run-off gradually, in order to avoid any market dislocations.

Bottom line

Very much as we expected, the FOMC stood pat with almost no changes to the meeting statement, and no change to the 2024 dot – still at 4-5/8%, implying three rate cuts. Also as we expected the Fed has upgraded its conception of the neutral rate. We see this in the fact that while there are upgraded forecasts for growth and unemployment this year, there is no change to the inflation estimate. Powell wrote of hot January and February readings as driven by seasonal factors, much as we have argued. The "longer-run" dot was raised slightly, the first time above 2-1/2% in over five years. Powell acknowledged this was because of a version of our view that the post-GFC era of "secular stagnation" is over. Powell announced that slowing the pace of securities run-off with come "fairly soon," and subject to further discussion. It will be a gradual process, to minimize market disruption. We don't see this as significant, because we see "quantitative tightening" as something of a myth.

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